Supreme Court, U. S.
FILED
FEB 8 1979
MICHAEL RODAK, JR., CLERK

No. 78-1030

In the
Supreme Court of the United States
October Term 1978

SIDNEY EPSTEIN, et al.,
Petitioners,

vs.

DAVID L. GOODMAN, et al.,
Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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QUESTION PRESENTED

The question presented is whether, in a Rule 10B-5 case, the Court of Appeals was correct in reversing the District Court based on a jury instruction which permitted misrepresentation and factual omissions in connection with a sale of a security and before substantial capital contributions were made.

STATEMENT

The Court of Appeals correctly reversed the District Court due to the erroneous jury instruction which simply eliminated from the case any fraud occurring prior to substantial capital contributions. The District Court instructed the jury that each capital contribution made after the for-

mation of the limited partnership did not constitute a purchase of a security, thereby immunizing any fraud which occurred after the execution of the limited partnership agreement but before the capital contributions.

The facts are accurately stated in the Court of Appeals' opinion. A brief review will be helpful to demonstrate that this case presents no question of general importance which merits further review by this Court and that the decision of the Court of Appeals was correct.

In late June 1972, a limited partnership agreement was executed between certain respondents as limited partners and petitioners as general partners to develop, construct, and operate certain apartment buildings in suburban Chicago, Illinois. The limited partnership was formed pursuant to the Uniform Limited Partnership Act in force in Illinois. Ill. Rev. Stats., Chap. 106½ § 44-73.

The limited partners agreed to furnish to the limited partnership a total capital contribution of $3,000,000 for "Phase I" operations. The agreement and amendment called for contributions of capital by limited partners "from time to time, upon the request of the general partners." As stated by the Court of Appeals, although the general partners could have requested a lump sum payment, the agreement contemplated a number of separate contribution transactions over an extended period of time. (App. 50a).

Subsequently, a certificate of limited partnership dated July 1972 was executed and filed effective January 1, 1972. Between July 1972 and June 1974, respondents made several substantial capital contributions.* In Court I of their Complaint filed on February 23, 1976, respondents charged

* Respondent Lee A. Freeman, Jr. made a capital contribution as early as December 1971.

that they were induced by petitioners to make these capital contributions to the limited partnership on the basis of fraudulent misrepresentations and omissions of material facts that violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, 17 C.F.R. § 240.10b-5.

At trial, over respondents' objections, the District Court gave petitioners' instruction, reading as follows:

> For the purposes of Count I, if you find that a limited partnership interest obtained by a plaintiff constituted a security, the purchase of such security occurred when such a plaintiff was committed or obligated by agreement to acquire such interest, even if such plaintiff was to perform his or her obligations under the agreement after a lapse of time, *each subsequent capital contribution made pursuant to such an agreement does not constitute a purchase of a security.* (Tr. 4641-4642) (emphasis added).

As the Court is aware, there is no federal statute of limitations governing Rule 10b-5 actions and, accordingly, the limitations period is determined by reference to state law. An action under this Rule is governed by the three-year statute of limitations found in the Illinois Security Act. *Parrent* v. *Midwest Rug Mills, Inc.*, 455 F.2d 123, 126 (7th Cir. 1972); Ill. Rev. Stats., Chap. 121½ § 137.B, sub. D.

Because the limited partnership agreement and amendment were executed in June 1972, the Court of Appeals held that, under the foregoing limitations rule, the District Court's instruction amounted to an incorrect peremptory direction to the jury that only the limited partnership agreement could be considered as the purchase of a security. Reversing the lower court's judgment, the Court of Appeals held that such a direction eliminated any change of respondents' obtaining a favorable verdict on their Count I. (App. 43a, 44a).

In arriving at its sound conclusion, the Court of Appeals reviewed the petitioners' reliance upon the "commitment" doctrine established in *Radiation Dynamics, Inc.* v. *Goldmuntz,* 464 F.2d 876 (2d Cir. 1972) and the petitioners' related contention that the limited partners were irrevocably committed as of the date of their agreement. (App. 44a). The Seventh Circuit properly distinguished *Radiation Dynamics* on the ground that the investment decision in that case was completed at the time the contract was made between purchaser and seller (in effect a "one-shot deal") and that no continuing relationship was contemplated as was in the instant case. (App. 49a, 50a) The Court of Appeals concluded:*

> In the case now before us, the circumstances are substantially different from those faced by the *Radiation Dynamics* court. What we have here is *not* a one-shot deal. The seller-defendants were required (as General Partners under the terms of the Limited Partnership Agreement) to perform certain management functions which were the primary determinants of the value of the securities sold. Most of these management functions were to be performed after the execution of the Limited Partnership Agreement and the contributions of capital (though they could have been expressly lumped into one up-front payment) were spaced out, "from time-to-time," over the course of the management's performance. The parties clearly envisioned an ongoing relationship under the Agreement with the management making all of the decisions affecting the basic value of the enterprise and its chances of progressing toward its advertised goal. Because of this ongoing relationship and the fact that the entire $3,000,000 for Phase I was not collected "up front" but was to be contributed "from time-to-time" as Phase I progressed toward completion, the purchasers were left with the possibility of an investment decision each time a call was made. (App. 50a).

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* Because of petitioner's heavy reliance—both here and below—upon *Radiation Dynamics,* a few additional remarks are appropriate to place that case in its proper context.

The discipline of *Radiation Dynamics* is that, within the SEC's rule prohibiting the use of inside information in the "purchase and sale" of a security, the time of "purchase and sale" is determined by reference to the time when the parties to the transaction are committed to one another and a party does not use inside information unfairly when he fulfills contractual commitments incurred previous to his acquisition of the information.

Radiation Dynamics merely establishes a rule for determining the time of a *single* purchase or sale in deciding whether someone has lawfully used inside information. The case does not concern the applicable statute of limitations; nor does it concern whether a purchase or sale of a security occurs when, by fraud by general partners, a limited partner is induced to make further capital contributions to a limited partnership.

REASONS FOR DENYING THE PETITION

A. The Petition Should Be Denied Because It Presents No Question Worthy Of Review By This Court.

The mere statement of the case shows that it presents no question of general or national importance; rather, all that is involved is a narrow point of law: whether respondents' claims for recovery of their limited partnership capital contributions under Rule 10b-5 are barred by the 3-year Illinois Statute of Limitations, as petitioners' instruction, in legal effect, told the jury. Respondents contend that each capital contribution to the limited partnership constituted a separate purchase of a security which was not time-barred. The validity of this contention turns upon the nature of respondents' obligations to make capital contribution payments under Illinois law, as the Petition argues at pp. 15-18.

This Court's Rule 19(1)(b) indicates the character of reasons which will be considered in reviewing petitions for writs of certiorari. Significant reasons exist where a Court of Appeals has decided an important question of federal law, which has not been, but should be, settled by this Court, or has decided a federal question in a way in conflict with applicable decisions of this Court.

The narrow question presented by this case does not meet any criteria set forth in this Court's Rule. Although the Petition asserts that the Court of Appeals' decision is inconsistent with *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462 (1977); *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976); *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975), none of these decisions concern the limitations question presented by the District Court's erroneous instruction.

In brief, petitioners are seeking further review by this Court of a generally unimportant question of federal law which is inextricably interwoven with the question of the interpretation of the Illinois Limited Partnership Act. Of course, this Court does not sit as a "super" court of appeals to review anew all questions of federal law determined by its eleven courts of appeal. "[Certiorari] jurisdiction was not conferred upon this Court merely to give the defeated party in the Circuit Court of Appeals another hearing" (*Magnum Import Co.* v. *Coty,* 262 U.S. 159, 163 (1923) or "for the benefit of the particular litigants" (*Rice* v. *Sioux City Cemetery,* 340 U.S. 70, 74 (1955), but to decide issues the "settlement of which is of importance to the public as distinguished from that of the parties (*Lane & Bowler Corp.* v. *Western Well Works, Inc.,* 261 U.S. 387, 393 (1923))

The Petition repeatedly asserts that the Seventh Circuit's decision undermines the law of virtually all states that limited partners must fulfill their capital contribution commitments. This Court's *certiorari* jurisdiction is ordinarily not exercised to determine whether a court of appeals has correctly resolved a question of state law. At any rate, petitioner's substantive contention is patently wrong because it hardly can be seriously contended that, as against a general partner (as distinguished from creditors of a limited partnership), a limited partner cannot defend an executory obligation to make further capital contributions on the grounds that the general partners are guilty of fraudulent misrepresentations or omissions under Rule 10b-5 in connection with the demand.

B. The Petition Should Be Denied Because The Case Was Correctly Decided by the Court of Appeals.

Petitioners erroneously contend that, for purposes of the Securities Exchange Act of 1934 and Rule 10b-5, a "purchase" of a security occurs only when the limited partnership agreement is signed and no "purchase" occurs thereafter when limited partners make periodic capital contributions required by the partnership agreement.*

As set forth by the Court of Appeals, this is not a circumstance where respondents sued for Rule 10b-5 damages for a fraud in a security sale that was fully consummated more than three years prior to the filing of the action. Under the limited partnership agreement at issue, respondents' obligation to make cash contributions was

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* As the Court of Appeals noted, all the lower courts that have considered the question, the Securities and Exchange Commission, and commentators uniformly agree that a limited partner interest constitutes a security under the Securities Exchange Act of 1934. (App. 36a, 39a). Petitioners apparently do not contest this issue here.

still executory when each of the alleged frauds was perpetrated. Whatever may have been the rights of creditors, if respondents knew about a fraud, they could have successfully resisted any action by the general partners to recover the unpaid contributions.

Because of the continuing nature of the relationship between the general and limited partners, the latter had to make independent investment decisions when the general partners called for capital contributions. The limited partners were prevented from making an independent investment decision due to the frauds perpetrated upon them. The Court of Appeals opinion correctly notes that the obligation of the limited partners was to make capital contributions toward the construction of what was denominated "Phase I" of the development, (App. 10a), and that the limited partners had the right to withdraw from participation in any other investment activity. (PX 5 ¶ 24; Tr. 1629; PX 3, 4, 137, 177). *See also* Ill. Rev. Stat., Chap. 106 §§ 31, 32, 35(c).

There was no construction undertaken on Phase I due to several problems encountered by the general partners. Phase I was completely abandoned in March 1973, when the general partners asked the municipality involved to return $140,000 previously paid to obtain building permits. (PX 59). These material facts were admittedly not disclosed to the limited partners and, in fact, were actively and intentionally concealed. Nevertheless, the general partners made a $500,000 capital call in April of that year but purposely omitted to state either the purpose of the call or the deteriorated and abandoned condition of the project. (App. 10a).

The instant factual situation is closely akin to those District Court decisions which hold that an actionable federal

securities claim exists when a fraud is perpetrated in inducing a purchaser to continue to make periodic installment payments in connection with the purchase of a security. *Ingenito* v. *Bermec Corp.*, 376 F. Supp. 1152, 1154 (S.D.N.Y. 1974); *Gross* v. *Independent Shares Corp.*, 36 F. Supp. 541 (E.D. Pa. 1941); *SEC* v. *North American Finance Corporation*, 214 F. Supp. 197 (D. Ariz. 1959); *United States* v. *Kormel, Inc.*, 230 F. Supp. 235 (D. Nev. 1964).

An analogous decision involving an executory obligation to pay for a security by a defrauded purchaser is *Davis* v. *Davis*, 526 F.2d 1286 (5th Cir. 1976). There, defendants contracted to purchase plaintiff's stock. After the contract was executed, plaintiff claimed that defendants entered into a fraudulent scheme designed to force plaintiff to sell his shares at prices less than those fixed by the contract. The Court of Appeals for the Fifth Circuit held that "Even though the alleged scheme did not arise until after the contracts to sell had been entered, we agree with the District Court that it is still 'in connection with the sale.' Payment has not yet been made pursuant to the contracts and the purpose of the scheme is to reduce the amount of that payment." 526 F.2d at 1290.

If petitioners succeed in their contention that the limited partners were "committed," without alternative or further right, to make cash contributions after the expiration of the applicable state statute of limitations, the general partners could—with impunity and despite the dictates of Rule 10b-5—commit any manner of fraudulent acts or omissions to obtain additional capital contributions. Further, petitioners' view leads to the equally absurd conclusion that a securities claim may be barred before it even arises. For example, if the limited partnership were honestly entered into and no fraud was perpetrated by the

general partners until calls for additional contribution are made after the expiration of the applicable state statute of limitations,* the defrauded party, according to petitioners, is without remedy under the federal Act.** This is simply not the law.

CONCLUSION

The Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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* This may be as short as one or two years in many states. 5A Jacobs *The Impact of Rule 10b-5* § 235.02 (1978)

** Under Section 2, VII of the Uniform Act, it is provided that the certificate shall state, "The additional contributions, if any, may be agreed to be made by each limited partner at the times at which, or events on the happening of which, they shall be made." Ill. Rev. Stats. Ch. 106½, § 45, VII).